No. 12481

In The United States Court of Appeals
For the Ninth Circuit

FAY J. HANSEN, *Appellant,*

vs.

ERNEST A. JONSON, RECEIVER OF VITA PAKT ASSOCIATES, INC., An Insolvent Corporation, and R. C. NICHOLSON, TRUSTEE OF THE ESTATE OF FAY J. HANSEN, BANKRUPT, *Appellee.*

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

BRIEF OF APPELLEE

BARKER & DAY, and
WILLIAM J. WALSH, JR.,
Attorneys for R. C. Nicholson, Trustee, Appellee.

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BRIEF OF APPELLEE

STATEMENT SHOWING JURISDICTION

District Courts of the United States are invested by Sec. 2(7) of the U. S. Bankruptcy Act (11 U.S.C.A. Sec. 11(7)) with original jurisdiction to determine controversies in relation to estates of bankrupts. Sec. 2 (11) of the Act confers jurisdiction on said courts to determine all claims of bankrupts to their exemptions. District Court judges are given power to consider records, findings, and orders certified to them by referees, and to confirm, modify or reverse such findings and orders, by Sec. 2 (10) of said Act.

Sec. 24 of the U. S. Bankruptcy Act (11 U.S.C.A. Sec. 47) vests appellate jurisdiction from the courts of bankruptcy in the United States Courts of Appeal.

The Referee's Findings of Fact (Par. IX) and Conclusions of Law (Par. V) On Show Cause Hearing (R. 35-46) and the Order on Show Cause Hearing (R. 49) and Supplemental Order On Show Cause Hearing (R. 47) denied the trustee's petition to set aside the order allowing the bankrupt his exemptions and expressly granted the bankrupt's claim to exemptions.

The Trustee timely filed his Petition for Review of the Referee's order. The District Court in the Order on Petition to Review (R. 79) reversed the Referee's order and denied the bankrupt his claimed exemptions, from which order the bankrupt has appealed to this court.

COUNTER-STATEMENT OF CASE

The trustee, in order to avoid any misunderstanding as to the issues involved, supplements the appellant's Statement of The Case in regard to the question of exemptions (with which the trustee is solely concerned), in the following particulars:

The assets of the bankruptcy estate have been reduced to cash pursuant to stipulation by all parties. The amount realized is $9,270.59. Of this sum the bankrupt claimed by way of exemptions $4,500.00, and the receiver of the corporation claimed he was entitled to trace and identify corporate funds misappropriated in the amount of $5,897.00. By the District Court's order the receiver did in fact reclaim $5,897.00, and the balance, $3,373.59, was awarded to the trustee for the benefit of the creditors of the estate free of any claim of exemptions by the bankrupt.

The bankrupt sought to have the transfers of his property to the corporation set aside on the ground that the transfers were made under duress in order that he might obtain his exemptions from the assets so recovered by the trustee. The trustee petitioned to have the transfers set aside on the ground that they constituted voidable preferences in order that these assets might be recovered for the benefit of the creditors of the bankrupt estate.

Therefore, contrary to the statement appearing on page 5 of Appellant's Opening Brief, the trustee did not join in the bankrupt's petition to set aside the bankrupt's conveyances to Vita-Pakt Associates, Inc., which petition was grounded on the allegation that transfers were made under duress; but rather the trustee filed a separate petition (R. 3, 27; Original Pleading 8-8) seeking an adjudication of the title to the property so transferred on the ground that the transaction constituted a voidable preference or fraudulent transfer as to the bankrupt's creditors.

After a hearing on these two petitions, the Referee declared the transfers invalid as to the trustee for the reason as stated by him in his Memorandum Decision (R. 30) that they constituted voidable preferences.

Before any order or findings were entered, but after the Referee announced his decision indicating that he would not make a specific determination that the transfers were procured by duress, (as had been requested by the bankrupt), the trustee orally petitioned the Referee to set aside his former order approving the allowance of the bankrupt's claim of exemptions. The Ref-

eree stated he would consider the trustee's original petition amended to embrace this request (R. 41). He considered the facts previously adduced in their application to this petition of the trustee, listened to argument of counsel and considered the authorities submitted (R. 268), and thereafter denied the petition on the merits as appears in his conclusions at Par. V (R. 46), Order On Show Cause Hearing Par. III (R. 49) and Supplemental Order On Show Cause Hearing Par. I (R. 47).

On petition for review the District Court disallowed the bankrupt's claim of exemptions for the reason that the transfer of all the bankrupt's property to the corporation constituted a voidable preference (R. 73-74). The District Court's grounds for disallowing the exemptions were twofold: (1) The Referee erred in that he should have upon reconsideration vacated his prior order allowing the exemptions, and (2) the District Court of its own motion had power to deny the bankrupt his exemptions and should do so. (District Court's Conclusions Par. V and VI) (R. 74).

SUMMARY OF APPELLEE'S ARGUMENT FOR AFFIRMANCE

The bankrupt-appellant attacks the District Court's denial of his exemptions for two reasons: (1) That he is entitled to his exemptions on the merits, and (2) that in any event after the entry of the Referee's original order approving the allowance of exemptions, (a) such order could not be reconsidered by the Referee, (b) although the Referee did in fact entertain a petition to reconsider his original order, and by order refused to vacate it on the merits, the District Court could not review such order of refusal, and finally, (c) the District Court could not of its own motion deny the bankrupt's claim to exemptions.

The trustee-appellee contends the bankrupt is not entitled to claim any exemptions for the reason that the property which he seeks to have set over as exempt is the very property transferred by him and recovered by the trustee as a voidable preference. Under Sec. 6 of the Bankruptcy Act, property so transferred and recovered by the trustee cannot be made the subject of a claim of exemption.

Within one week of the filing of his voluntary petition herein, the bankrupt, while insolvent, transferred all his property without any present consideration therefor, to Vita Pakt Associates, Inc., a corporation which he had controlled and managed. The effect of the transaction was to permit the corporation to receive a greater percentage of its claim than other creditors of the same class. Therefore, the transfers constituted

voidable preferences within Sec. 60 of the U. S. Bankruptcy Act (11 U.S.C.A. §96), and the transaction could be avoided and the property so transferred recovered by the trustee for the benefit of the estate.

Under Section 6 of the U. S. Bankruptcy Act. (11 U.S.C.A. §24), as amended in 1938, a voluntary preferential transfer of property by the bankrupt, not in excess of any amount thereby secured, prohibits an allowance to the bankrupt of exemptions from the property so transferred regardless of the intent of the bankrupt in making the transfer. This is a matter of positive statutory law supported by court decisions.

The transfer of property to the corporation was not made under duress as alleged by the bankrupt, but rather constituted a voluntary act of making partial restitution for funds misappropriated from the corporate bank account.

The transfers of property by the bankrupt were not made as security. It is not a question of securing a "debt", but rather a matter of restitution or repayment. In any event, the amount of the property transferred by the bankrupt and recovered by the trustee did not exceed any obligation for which the transfers might have been security.

Obviously, the transfer did not constitute a general assignment for the benefit of creditors, since they were absolute transfers for the benefit of one creditor among many.

In response to the appellant's second contention, the Trustee-appellee submits: That the allowance of exemp-

tions by the trustee and their approval by the referee when viewed in the light of the facts evoked at the subsequent show cause hearing, were clearly erroneous.

The Referee had the authority to vacate his order approving the allowance of exemptions, although more than ten days had elapsed since its entry, and after his reconsideration of the merits of that order, he should have done so.

A petition for review from the Referee's order denying the petition of the trustee to set aside the prior exemption order after a reconsideration of its merits, is reviewable by the District Court.

At all events, the District Court has the inherent power on its own motion to disallow the bankrupt his previously allowed exemptions at any time during the pendency of proceedings.

Finally, the District Court's findings and conclusions in this particular case are entitled to great weight in view of the fact that the Court, as it has power to do, called the bankrupt and other witnesses, and heard their testimony in open court before rendering his decision.

ARGUMENT

The trustee-appellee will direct his argument for an affirmation of the District Court's decision solely to Specifications of Error Nos. I, V, and VII which cover the denial of the bankrupt's claim to exemptions. For purposes of orderly procedure, the trustee will answer the arguments of the bankrupt-appellant in the sequence in which they are set forth in appellant's opening brief.

This Court Is Not Limited to a Determination as to Whether or Not the Referee's Findings Are Clearly Erroneous.

The District Court accepted in part the findings of the Referee, but drew contrary conclusions of law from those ultimate facts. Both the Court and the Referee found that the transfers by the bankrupt constitued voidable preferences (R. 67,42). However, the Referee was of the opinion that this fact did not warrant a disallowance of the bankrupt's claim to exemptions under Sec. 6 of the Bankruptcy Act, while the District Court concluded as a matter of law that it did.

Questions of law must be distinguished from questions of fact, and the presumption of correctness of referee's findings is not extended by General Order 47 to his conclusions of law. 8 Remington on Bankruptcy (4th ed.) 38, §3719.

The Referee having set forth the ultimate facts in his findings expressly refused to state as a conclusion of law that the transfers were made under duress, although specifically asked to do so by the bankrupt. The District Court found that these transfers were not made under duress (R. 64).

The District Court's findings were not based merely upon a review of the record. That court upon three separate days heard the testimony of the bankrupt and other witnesses in open court (R. 227-256) as it is empowered to do under the provisions of General Order 47 (11 U.S.C.A. following §53). The court therefore was afforded the opportunity to judge the credibility of the witnesses for itself. Judge Black stated:

"I have based my decision upon the record plus the evidence which I have heard in court, supplemented by the fact that I have had an opportunity to look at the witnesses and see their manner of testifying. Certainly, the evasive testimony of Mr. Hansen yesterday supported the appearance of evasiveness in his testimony as transcribed previously.

"The version of a man who did not know whether he had a dollar's worth of stock or thirty thousand in a company that he had organized a little more than a year ago, and which ran its course about a year ago is incredible." (R. 263.)

Consequently we are not here confronted with the usual situation where the district judge reviews the matter upon the record, and to which the cases cited by appellant are applicable.

Upon review the district judge has full discretion to hear all or any part of the case de novo under General Order 47 and to make findings of fact and conclusions of law for himself. *In re J. Rosen & Sons* (1942; C.C.A. N.J.) 130 F. 2d 81; *In re Fineman* (1940; D.C. Md.) 32 F. Supp. 212.

This very court has said that where the district court receives further evidence, General Order 47 requiring the court to accept a referee or special master's finding unless clearly erroneous, is not applicable. *In re American Mail Line, Ltd.* (1940; C.C.A. 9) 115 F. 2d 196.

The Bankrupt Is Not Entitled to Exemptions On the Merits.

We are in complete accord with the statements of appellant appearing on pages 10-11 of his brief that

the exemption provisions of the Bankruptcy Act should be liberally construed to aid those unfortunates whose circumstances requires them to invoke it. However, the case at bar in which a long continued course of fraud and deceit is openly admitted by the bankrupt (R. 260) would hardly seem the place to seek the application of the rule.

The implication contained in the statement of appellant on page 14 of his brief that the District Court disallowed the exemptions because of the bankrupt's fraudulent activities is unwarranted. The court denied the exemptions on the specific ground that the bankrupt having made a preferential transfer of his property, could not thereafter claim exemptions out of the very property so transferred under the express provisions of Sec. 6 of the Bankruptcy Act (R. 74).

A. The proviso of Section 6 of the Bankruptcy Act is directly applicable to the facts of this case.

Section 6 of the U. S. Bankruptcy Act (11 U.S.C.A. §24) stating that bankrupts shall be allowed the exemptions permitted by state law, contains a proviso as follows:

> "Provided, however, that no such allowance of exemptions shall be made out of the property which a bankrupt *transferred* or concealed and which is recovered, or the transfer of which is avoided under this Act for the benefit of the estate, except that where the voided transfer was made by way of security only and the property recovered is in excess of the amount secured thereby, such allowance may be made out of such excess." (Italics ours.)

Appellant apparently concedes that his transfer of property to the corporation constituted a voidable preference; and it is difficult to see how he could do otherwise in view of the findings of the Referee (R. 42) and District Court (R. 67). He seeks to avoid the effect of the proviso by contending that the transfer must be made with an intent to deprive creditors of their rights. No such requirement exists. The provision is specific, unambiguous and mandatory. *Since this* 1938 *amendment to the Act,* all that is required to make the provision applicable is a transfer by the bankrupt of property out of which he subsequently seeks his exemptions and an avoidance of such transfer by the trustee.

Collier explains the background of the amendment in this comment:

> "Before the 1938 Act, the decisions were in sharp conflict as to whether the bankrupt might claim his exemptions from property which has been transferred or concealed and recovered by the Trustee.
>
> . . .
>
> "Under the terms of the act of 1938, the conflict has been stilled.
>
> . . .
>
> "The Act of 1938, by amendment of Section 6, made it clear that where a Trustee secures possession of property *preferentially transferred,* the bankrupt may not thereafter claim his exemptions out of that property." (Italics ours.) 3 Collier (14th ed.) 843, §60.25.

To the same effect is a statement of Mr. Watson B. Adair, member of the National Bankruptcy Congress, in House Hearings on H.R. 6439, 75th Congress, First

Session (1937) 29, quoted in 3 Remington on Bankruptcy (4th ed.) 235, §1276:

> "The report of the Judiciary Committee of the House on the proviso added to Section 6, 11 U.S.C.A. §24, by the Act of June 22, 1938 (The Chandler Bill) said: '2. Exemptions. — §6: In the proviso added to this section, no allowance shall be made for exemptions out of the property which is recovered after a preference or fraudulent transfer. The decisions are conflicting, and it is considered that the law should be clear . . .' "

B. The bankrupt did not transfer his property to the corporation under duress.

The bankrupt next attempts to escape the effect of his preferential transfer by claiming that the transfer was involunary and made under duress. This question of fact was resolved against the bankrupt who had the burden of proving his assertion. Neither the Referee or the District Court found or concluded that the transfers were procured by duress. On the contrary the District Court found after extended testimony on the matter (R. 235-247) that the property was transferred to Vita Pakt Associates, Inc. voluntarily in an effort to make partial restitution. (R. 64).

C. The transfer did not constitute an assignment for the benefit of creditors.

In the hope of avoiding the effect of his preferential transfer, and thus the disallowance of his exemptions under Section 6 of the Act, the bankrupt attempts to wrap his transfer of property to Vita Pakt Associates, Inc. in the guise of a general assignment for the benefit of creditors. The fact is that he made *absolute* transfers

(R. 194-201) of all his property to one of many creditors for the sole benefit of that particular creditor. Obviously, such transactions do not come within the definition of an assignment for the benefit of creditors.

Black's Law Dictionary (3rd ed.) states at page 155:

> "Assignment for benefit of creditors. An assignment in trust made by an insolvent or other debtors for the payment of their debts. . . .
>
> "An assignment for the benefit of creditors, with directions to the assignee to prefer a specified creditor or class of creditors . . . (is) more usually termed a "preferential assignment' ".

In 21 Corpus Juris Secundum 1223, §4e the rule is stated:

> "Failure to create a trust prevents a direct transfer to creditors from being an assignment for the benefit of creditors."

The quotation from Collier appearing on page 18 of appellant's brief concludes with this passage:

> "Only where the purported general assignment may amount to a fraudulent or preferential transfer should the proviso of section 6 be employed to deny the bankrupt his exemption to property." (1 Collier (14th ed.) 844.)

D. The transfer was not made by way of security; and in any event, the property transferred did not exceed the amount of the obligation.

Section 6 of the Bankruptcy Act provides that where the preferential transfer of property by the bankrupt is made by way of security *only* and the amount of property recovered by the trustee is in excess of the

amount secured by such transfer the bankrupt may be allowed his exemptions out of such excess.

The absolute transfers of property by bills of sale, assignments, and deeds did not constitute a security transaction, but rather acts of repayment or partial restitution. The record is entirely devoid of any testimony that the transfers were made by way of security. The bankrupt never claimed they were given as security (R. 91-92). The Referee's finding (R. 42) that the transfers were given as security is a pure inference from the evidence, and is contradicted by the findings of the District Court (R. 64, 68).

The word "security" implies the existence of a debt. As stated in Black's Law Dictionary (3rd ed.) 1595:

> "Security. The term is usually applied to an obligation, pledge, mortgage, deposit, lien, etc., given by a debtor in order to make sure the payment or performance of his debt, . . ."

The court in *Clinton Mining & Mineral Co. v. Beacon,* 266 Fed 621, 622 defined the word debt in these terms:

> "The word 'debt' carries with it the requirement of certainty, the foundation of promise by express contract, and necessarily implies legality."

The bankrupt himself denies that he was indebted to the corporation (R. 157). We submit that the testimony of the receiver that the bankrupt "owed" the corporation $16,000.00, quoted by appellant, was a reference to the fact the bankrupt had misappropriated corporate funds to that extent. Under these circumstances how can it be contended that the transfers were made *by way of security only?*

Even if we make the unjustified assumption that the

transfers were given as security, there is no excess out of which the bankrupt may claim exemptions. The only conceivable debt which the transfers could have been given to secure is the corporation's claim that the bankrupt misappropriated $16,000.00 from its bank account for his personal use (R. 61). The amount recovered by the trustee before deduction of the sums successfully reclaimed by the corporation was only $9,270.59.

E. State court decisions are no longer controlling in determining the right of a bankrupt to claim exemptions.

The bankrupt's final argument in support of his contention that he should be allowed his claim to exemptions on the merits, is that state court decisions are controlling in the matter of exemptions. The appellant confuses the paramount authority of the Bankruptcy Act (since its amendment in 1938) in determining *the right to exemptions* with the authority of state law in determining what exemptions are *allowable*. State law controls the extent of property that may be claimed exempt. Federal law is determinative as to whether the bankrupt is entitled to claim any exemptions.

The case of *Van Slyke v. Baumgarner* (1934) 177 Wash. 326, 330, 31 P. 2d 1014, cited by appellant at pages 21-23 of his brief, is inapplicable. That case *decided prior to the* 1938 *amendment* to Section 6 of the Act held that a bankrupt might claim exemptions out of property preferentially transferred. Obviously, this decision would not have been the same under the present Section 6 of the Act, which expressly prohibits the

allowance of exemptions out of property preferentially transferred. The change is described by Collier:

> "The Act of 1938, by amendment of Section 6, made it clear that where a Trustee secures possession of property preferentially transferred, the bankrupt may not thereafter claim his exemptions out of that property." (3 Collier (14th ed.) 843, §60.25.)

The appellant's citation of the case of *In re Dudley* (D.C. Calif.; 1947) 72 F. Supp. 943 is wholly inapplicable. No question of a preferential transfer was there involved. The court merely held that nothing in the Bankruptcy Act prohibited an insolvent from converting his non-exempt property into exempt property on the eve of bankruptcy. The case of *Turnbeaugh v. Santos* (C.C.A. 9) 146 F. 2d 168 is to the same effect. We have no quarrel with the rule announced in these decisions, but they have no bearing upon the question presented in the case at bar.

III.

Referee's Original Order Approving the Allowance of the Bankrupt's Exemption Is Not Res Judicata.

A. The referee had the power to reconsider and vacate his order allowing the bankrupt's exemptions.

The trustee takes the position that the Referee had the power to reconsider and vacate the order allowing the bankrupt's exemptions.

The Referee's Order Approving Trustee's Report of Exemptions was entered October 20, 1948. At that time, the bankrupt's position as evidenced in his petition and testimony under oath at the first creditor's meeting was that the transfer of all his property to Vita

Pakt Associates, Inc. was procured under duress. Several months after the entry of this order, the Referee at the conclusion of the Show Cause Hearing, specifically refused to conclude as a matter of law that the transfers by the bankrupt were made under duress. Thereupon, the trustee deeming that under this state of facts, the prior allowance of exemptions was erroneous, requested the Referee to vacate his Order Approving Trustee's Report of Exemptions. After hearing argument on the trustee's petition to vacate the order, and considering the authorities submitted by the trustee, the Referee decreed that the trustee's petition would be denied (R. 46-47) for the reason that he did not believe he had power to vacate his prior order (R. 268).

This procedure on the part of the trustee was proper. An ex parte order is not reviewable. The trustee should move to vacate it, and then to petition for review of the order refusing to vacate. 8 Remington on Bankruptcy (4th ed.) 10, §3703. To the same effect: *In re Snyder* (C.C.A. 9; 1925) 4 F. 2d 627 *In re Rustigan* (D.C. Calif., 1943) 50 F. Supp. 827.

The Referee, like any other court, has the power to vacate an ex parte interim order during the pendency of the bankruptcy proceeding.

2 Collier (14th ed.) 1426, §38.09.

> "Although there has been considerable authority that a Referee, once having made an order, has no such power to reconsider and amend or vacate it, the better view seems to be that the *Referee,* as a court, has such power."

2 Collier (14th ed.) 1475, §39.17.

> "*Referee's Power to Reconsider Order.* A dis-

> cussion of the Referee's power to reconsider his own orders appears in §38.09, Supra. As indicated in that section, it has frequently been argued that 'except in the matter of an allowed claim, Referee exhausts his jurisdiction by exercising it,' and that 'once having acted, a Referee may not review his own action'. The better view, however, would give the *Referee* the same power to reconsider or vacate his own orders as the District Judge has over his orders; 'That power is, of course, limited in duration when there are terms of court, but in bankruptcy there are none'."

The case of *In re Faerstein* (C.C.A. 9, 1932) 58 F. 2d 942, cited by appellant on page 28 of his opening brief to the effect that an order of a Referee is conclusive unless a petition for review is filed in the District Court within ten days of its entry was decided prior to the decision of the United States Supreme Court in *Wayne United Gas Co. v. Owen-Illinois Glass Co.* (1937) 300 U.S. 131, 57 S. Ct. 382, 81 L. ed. 557, and is therefore of no controlling force.

The United States Supreme Court, relying on the foregoing case, stated in *Pfister v. Northern Illinois Finance Corp.* (1942) 370 U. S. 144, 63 S. Ct. 133, 87 L. ed. 146:

> "Where a petition for rehearing of a Referee's order is permitted to be filed, after the expiration of the time for a petition for review, and during the pendency of the bankruptcy proceedings, as here, they may be acted on, that is, they may be granted 'before rights have vested on the faith of the action,' and the foundations of the original order may be re-examined. *Wayne United Gas Co. v. Owen-Illinois Glass Co....*"

In Indemnity Ins. Co. v. Reisley (C.C.A. 2; 1945) 153 F. 2d 296, the trustee on March 6, 1945 filed a petition for reconsideration of the Referee's order entered April 14, 1942. After a hearing, the Referee denied the petition on the ground that he no longer had the power to reconsider his prior order, and the District Court affirmed this decision. The then Circuit Court of Appeals reversed the decision saying:

> "The Insurance Company argues that the trustee's appeal is from the denial of the petition for reconsideration of an earlier order, and is therefore not appealable. We do not agree. This being a bankruptcy proceeding, the Referee as the Court of bankruptcy, had discretion to re-examine and vacate the former order."

B. The trustee is not estopped to seek a vacation of the referee's order allowing exemptions.

The appellant contends on pages 35-37 of his opening brief that the trustee is estopped from attempting to deny the bankrupt's claim to exemptions after they had been allowed.

It has heretofore been shown that at the time the exemptions were allowed, the position of the bankrupt was that he had transferred all his property under duress. The trustee was unaware of the true facts surrounding the transfers until the subsequent hearing on the show cause orders. Appellant's own citations of authority bear out the principle that there can be no estoppel where the person against whom the estoppel is claimed is ignorant of the true facts.

In the case of *Axelrod v. Osage Oil & Refining Com-*

pany (C.C.A. 8) 29 F. 2d 712, 729, cited by appellant, the complete statement of the court with the omitted portion in italics is as follows:

> "It seems to us that it is bound by this course of conduct, and the position so often taken, and cannot change its position after the Osage Company has relied and acted thereon. The Osage Company and the Continental Company were both bound by the pleadings in the light of the agreement and understandings, and both were estopped to take positions inconsistent therewith. *It is said in* 21 C.J. 1223, §227: '*A party who has with knowledge of the facts assumed a particular position in a judicial proceeding . . .*'".

The omission (set forth in italics) from appellant's quotation from the case of *Sinclair Refining Company v. Jenkins Petroleum Process Company* (C.C.A. 1) 99 F.2d 9, 13 is pertinent:

> "*There is obviously no estoppel by deed, nor are the elements present to constitute an estoppel in pais, or equitable estoppel. To constitute such an estoppel, all the essential elements must be present, among which is ignorance of the true facts on the part of the person claiming the estoppel.* The general rule is that one may not to the prejudice of the other party deny any position taken in a prior judicial proceeding between the same parties or their privy involving the same subject matter, if successfully maintained."

C. The District Court Had Jurisdiction to Review the Referee's Order Denying the Trustee's Petition to Set Aside the Allowance of Exemptions.

The trustee grants that no petition has ever been filed to review the Referee's original "Order Approv-

ing Trustee's Report of Exemptions," dated October 20, 1948. However, upon petition therefor, the Referee reconsidered and re-examined the merits of the Order Approving Allowance of Exemptions, and thereafter denied the petition to set aside the allowance of exemptions. A petition for review lies as a matter of right from this subsequent order of denial by the Referee.

Chronologically, the matters leading up to the filing of the Petition for Review were as follows: The Trustee's Report of Exempt Property was filed September 3, 1948. No objections to this report having been filed within the ten days prescribed by General Order 17, the Referee entered his *ex parte* Order Approving Trustee's Report of Exemptions on October 2, 1948. During the pendency of the Show Cause Hearing, when it became apparent that the bankrupt's transfers of property to the corporation were not made under duress, the trustee orally petition the Referee to reconsider and set aside his former order approving the allowance of exemptions. The Referee entertained this petition (R. 41). He considered the authorities submitted, and heard argument of counsel (R. 268), and after such re-examination of the merits of his original order (R. 69), denied the trustee's petition to disallow the exemptions (R. 46-47). He stated his reasons for the denial of the petition as being that he doubted the proviso of Sec. 6 of the Act would prohibit the allowance to the bankrupt of exemptions from property preferentially transferred, and that he did not think he had authority to vacate his prior order after the time for appeal therefrom had expired (R. 268). This fact is evidenced by the question proposed in his Certificate

on Review (R. 7). Thereafter, the trustee sought a review in the District Court of the Referee's order of denial by filing his Petition for Review within the time prescribed by Sec. 39c of the Act (11 U.S.C.A. §67c).

It should be noted that the Referee did not refuse to entertain and reconsider the trustee's petition, but rather having entertained the petition and re-examined the merits of the original exemption order, he entered an order refusing to vacate the prior exemption order.

Under this state of facts, the case cited by appellant on page 33 of his brief, *Bernards v. Johnson* (1941) 314 U. S. 19, 86 L. ed. 11, is not in point. That case holds that an order of a conciliation commissioner denying a petition for rehearing which is dismissed because the petition was filed out of time, *without reconsideration of the merits,* does not extend the time for appeal from the original order.

The rule applicable to the case at bar is that even though a petition for rehearing is not filed until after the expiration of the period limited for review, if such petition is filed in good faith and is entertained and considered on its merits, a petition for review taken within the statutory period after disposition of such petition is timely.

Wayne United Gas Co. v. Owens-Illinois Glass Co. (1937) 300 U.S. 131, 81 L. ed. 557, 57 S. Ct. 382;

Pfister v. Northern Illinois Finance Corp. (1942) 317 U.S. 144, 87 L. ed. 146, 63 S. Ct. 133;

Indemnity Ins. Co. v. Reisley (1945, C.C.A. 2) 153 F. 2d 296, cert. den. 328 U.S. 857, 90 L. ed. 629, 66 S. Ct. 1349;

In *Pfister v. Northern Illinois Finance Corp.* (*supra*) the court said at page 137:

> "When such a petition for rehearing is granted (by the conciliation commissioner) and the issues of the original order are re-examined, and an order is entered their denying or allowing change in the original order, the time for review under Sec. 39c begins to run from that entry (citing cases)."
>
> . . . .
>
> "It is quite true that in a petition for review *upon the ground of error in law* in the original order, the examination of the grounds of the petition for rehearing is equivalent to a re-examination of the basis of the original decree." (Italics ours.)

In *Indemnity Insurance Co. v. Reisley* (*supra*), an order of a referee entered April 14, 1942 was the subject of a petition for reconsideration filed by the trustee on March 6, 1945. Upon denial of the petition, the trustee filed a petition for review in the District Court. The Court of Appeals held the petition for review was timely, stating:

> "On Petition for Rehearing.
>
> "As the order of April 14, 1942, was based upon the reclamation petition, we erred in our original opinion when we said that Section 57 Sub K, 11 U.S.C.A. §93 sub k, governed. Nevertheless, Rule 16(b),.28 U.S.C.A. following Sec. 723c is not applicable because it relates only to a final order; and no order in a bankruptcy proceeding is final, (in

the sense that it cannot be reopened) until the proceeding has been terminated.

. . . .

"The petition for review was timely. For where an application is made for reconsideration, the time for review begins to run from the date of denial of such relief, provided the referee reconsiders the merits of the original order. We think that the referee did thus reconsider the merits, for he based his denial of the relief on res judicata (i.e. the rejection of a previous petition for reconsideration) which was a defense on the merits."

Appellee submits that the timely filing of his petition for review under Sec. 39(c) of the Act gave him as a matter of right the opportunity to have the District Court review the Referee's action in denying the petition to set aside his former exemption order.

The contention of appellant that because no petition for review of the Supplemental Order on Show Cause Hearing was ever filed, the District Court's decree is rendered invalid, mistakes the office of that pleading. Its purpose was merely to clarify the provisions of the Order On Show Cause Hearing, which is the subject of the Petition for Review. Upon the testimony of the attorneys and the Referee, the District Court found the trustee's petition to vacate the order allowing exemptions was before the Referee, was embraced in his findings and conclusions, and was in fact denied by him, and that the supplemental order is not necessary to make such denial effective. (R. 69, 275.)

D. The District Court in the exercise of its inherent powers, denied the bankrupt's claim to exemptions on its own motion.

In addition to reversing the order of the Referee on the ground that he should have after reconsideration set aside his order allowing the bankrupt's exemptions, the District Court after hearing denied the bankrupt's claim of exemptions *on its own motion.*

Counsel for the bankrupt conceded in open court that the court had inherent power to do so.

8 Remington on Bankruptcy, §3724, page 25 (Suppl.):

> "A District Judge may at any time sua sponte entertain a petition to review an order of the Referee. (Citing: *Heiser v. Woodruff,* 150 F. 2d 867 (1945, C.C.A. 10); cert. den. 326 U.S. 778.)"

8 Remington on Bankruptcy, §3724, page 42:

> "*Review on Judge's Initiative.* The judge has authority on his own initiative to review any order of the Referee before the estate is closed. (Citing cases.)"

The United States Supreme Court in *Pfister v. Northern Illinois Finance Corp.* (1942) 317 U. S. 144, 63 S. Ct. 133, 87 L. ed. 146 granted certiorari because of a conflict in circuits as to whether the ten day period for filing a peition for review was a limitation on the right of an aggrieved party to appeal, or on the power of the reviewing court to act.

Justice Reed speaking for the court said:

> "We do not think Section 39(c) was intended to be a limitation on the sound discretion of the Bankruptcy Court (District Court) to permit the filing of petitions for review after the expiration of the

period. The power in the Bankruptcy Court to review orders of the Referee is unqualifiedly given in Section 2 (10). The language quoted from Section 39(c) is rather a limitation on the 'person aggrieved' to file such a petition as a matter of right."

CONCLUSION

We submit that under the mandatory provisions of Sec. 6 (11 U.S.C.A. §24) as applied to the facts in the case at bar, the bankrupt is not entitled to an allowance of exemptions; that the District Court had jurisdiction to review the findings and order of the Referee, and the Court's decision reversing the order of the Referee and denying the bankrupt's claim to exemptions on the District Court's own motion, should be affirmed.

Respectfully submitted,

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